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RUEHSP/AMEMBASSY PORT OF SPAIN 3702
RUEHQT/AMEMBASSY QUITO 2983
RUEHSG/AMEMBASSY SANTIAGO 4113
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C O N F I D E N T I A L SECTION 01 OF 05 CARACAS 000581

SIPDIS

ENERGY FOR CDAY AND ALOCKWOOD, DOE/EIA FOR MCLINE
HQ SOUTHCOM ALSO FOR POLAD
TREASURY FOR RJARPE
COMMERCE FOR 4332/MAC/WH/JLAO
NSC FOR RKING

E.O. 12958: DECL: 05/08/2019
TAGS: EPET EINV ENRG ECON VE
SUBJECT: VENEZUELA: PDVSA SEIZES SERVICE COMPANIES

Classified By: A/Economic Counselor Richard T. Yoneoka,
for reasons 1.4 (b) and (d).

¶1. (C) Summary: On May 7, the National Assembly passed and President Chavez promulgated a law permitting the expropriation (partial or total) of companies involved in the oil services industry. PDVSA officials accompanied by the National Guard quickly began the transfer of assets and operations from several international companies and many Venezuela service companies. The subject companies have not been informed of the GBRV's intentions nor of the extent of the seizures. Petroleum industry companies have focused on seeking legal advice and exploring options available to them. The question at this point is how far service companies will go to limit their exposure to Venezuela. It is hard to imagine Venezuela stabilizing production, let alone increasing it, if it does not have the support of the service companies.

¶2. (C) The main purpose of the bill is to transfer to the GBRV the assets owned and operated by service companies involved with the primary activities (upstream and midstream) governed by the Organic Hydrocarbons Law. The bill specifically affects companies involved with the injection of water, steam, or gas, the compression of gas as well as services rendered for the performance of primary activities on Lake Maracaibo. It provides for the "extinction" of contracts executed in the past between PDVSA and private companies. It stipulates that all contracts and activities governed by the law would be subject to Venezuelan law and subject to the exclusive jurisdiction of Venezuelan Courts.
END SUMMARY.

The Law Nationalizing Oil Services Companies

¶3. (C) The National Assembly on May 7 passed after second discussion the Bill of the Organic Law that Reserves to the State the Assets and Services related to Hydrocarbon Primary Activities. President Chavez promulgated the bill the evening of May 7. Legal experts in Caracas expect it will be

sent to the Official Gazzette for publication on May 8 (Note: the following legal analysis is drawn from confidential reports provided to Post by several local petroleum sector law firms). Legal analysts highlight the main purpose of the bill is to transfer to the GBRV the assets owned and operated by private companies that until now have performed services in connection with the primary activities (upstream and midstream) governed by the Organic Hydrocarbons Law. The bill specifically affects companies involved with the injection of water, steam, or gas, the compression of gas as well as services rendered for the performance of primary activities on Lake Maracaibo.

¶4. (C) The law provides for the "extinction" of the contracts executed in the past between PDVSA (or its affiliates) and private companies for the rendering of services or the operation of the assets subject to the reserve. It provides that all events, activities, contracts governed by the law would be subject to Venezuelan law and disputes arising there from will be subject to the exclusive jurisdiction of Venezuelan Courts. This will likely affect contractual claims that the affected companies may have under their respective contracts and the possibility to resort to arbitration based on arbitration clauses included in such contracts (but not investment arbitration claims filed under Bilateral Investment Treaties (BITs) to which Venezuela is a party).

¶5. (C) The law provides that the reserved assets may be expropriated under very unfriendly conditions for

international investors, including for instance, that compensation will be based in the book value of the assets and allows payments through securities or obligations issued by public entities.

¶6. (C) Key provisions of the bill include:

- Article 1 justifies the reserve in the "strategic character" of the assets and services it refers to, and provides that the reserved activities can only be performed directly by the Republic, by PDVSA (or its affiliates) or by mixed companies under the control of PDVSA or its affiliates. Thus, it is possible that the GBRV could negotiate with the affected companies the formation of mixed (joint venture) companies with majority GBRV participation in a similar fashion to those created to replace the Operating Agreements and the Association Agreements in the Faja heavy crude region.

- Article 2 provides a general description of the assets and services subject to the reserve. Specifically it mentions the following:
    - assets and services for the injection of water, steam or gas, which increase the energy of the reserves and improve the recovery factor;
    - assets and services for the compression of gas; and
    - assets and services related to the activities on Lake Maracaibo.

Article 2 expressly includes boats for the transportation of personnel, divers and maintenance; crane barges for the transportation of materials, diesel, industrial water and other inputs; flat barges, boyeras, cranes, cuttings barges, pipeline and sub-aquatic cable laying or replacing barges; ship maintenance in workshops, docks and any type of dykes.

- Article 3 provides that the Ministry of People's Power for Energy and Petroleum (MENPET) will determine, through a special resolution, the specific assets owned, and the services rendered by, the companies and sectors covered by the reserve to which Articles 1 and 2 refer. It is possible that some, but not all, of the assets used for a specific project will be covered by this reserve. This could create a scenario for the companies affected where it would be

difficult or impossible to use the remaining assets for other activities or either sell or lease the same to third parties.

- Article 3 provides that contracts will be "extinguished" upon issuance by MENPET of the special resolutions that identify the assets and services covered by the reserve. This would affect the possibility of filing claims under such contracts and invoking the arbitration clauses contained therein.

- Article 4 provides that MENPET will take the measures necessary to guarantee the continuity of the reserved activities and that the affected companies will be required to cooperate with the peaceful and orderly transfer of the operations, facilities, documents, assets and equipment or be subject to administrative or criminal penalties. Since there is no deadline for the transfer of the assets to PDVSA, the process could take several months, which would entail that the affected companies would be required to fund the costs of maintaining the continuity of operations until the transfer to PDVSA is finally completed.

- Article 6 states that the National Executive may order the full or partial expropriation of the shares or assets of the companies that perform the services subject to the reserve. In addition, the article expressly provides that loss of

profits or indirect damages will not be subject to compensation in the expropriation process. Furthermore, the article provides that labor and environmental liabilities will be discounted from the amount of the compensation to be paid to the affected parties and that the time of possession of the expropriated assets that may elapse prior to the payment of compensation should be computed in order to calculate such compensation.

- Article 10 provides that MENPET will determine which employees of the affected companies will be transferred to PDVSA. It also provides that the labor benefits of these employees may be paid directly by PDVSA, deducting the corresponding amounts from the compensation that may be paid to the expropriated companies.

- Article 11 provides that the events, activities, and contracts governed by the law will be governed by Venezuelan law and that disputes arising there from will be resolved exclusively by Venezuelan Courts. Depending on the case, this provision may affect the opportunity for the affected companies to have recourse to arbitration under the relevant contracts with PDVSA but does not prejudice their right to file for investment arbitration under a BIT before ICSID or another international tribunal.

MENPET AND PDVSA ACTIVITY

Williams
¶7. (C) At midnight May 8, PDVSA officials (60 each at the El Furrial and PIGAP II projects and 40 at the Accroven facility), including PDVSA lawyers and a judge arrived at the Wilpro (Wilpro is Williams' local operator) facilities to take possession of the assets. Sometime after PDVSA's teams began the transfer process at the Wilpro facilities, National Guard units arrived. Williams' employees and officials cooperated with PDVSA in the inspections, documenting the state of the facilities and equipment, turned over operations manuals, and responded to information requests during the night. At 5:00 a.m. on May 8, the transfer was complete. PDVSA officials failed to provide Williams with the required MENPET resolution (Article 3) concerning the assets being reserved to the state.

Lake Maracaibo
¶8. (C) According to Evanglos Alexandros Hadjis (strictly protect throughout), the owner of two oil service related

vessels on Lake Maracaibo and the honorary Greek Consul in Maracaibo (strictly protect throughout) PDVSA seized the morning of May 8 Zulia Towing and Barge, Tricomar, Hermanos Papagaiou, and Costa Bolivar. Each of these companies (some foreign-owned by Italians whose legal residency in Venezuela is unknown) was located at a shared dock facility on Lake Maracaibo. Hadjis' two vessels are located at the same dock. As his company does not provide direct services to PDVSA, but sub-contracts to other service sector companies, PDVSA officials told him his vessels were not being seized. U.S. Consular Agent in Maracaibo informed PetAtt that in addition, ZNP and Kraf assets had been seized.

¶9. (C) Tidewater Country Manager Mikael Jacob (strictly protect throughout) told PetAtt that as of 11:00 a.m. May 8 there were two buses filled with PDVSA employees and National Guard sitting outside Tidewater's base on Lake Maracaibo. It appeared that they were waiting for orders to enter the base and assume operations. He has not heard that TidewaterQ,s boats in Petrosucre (eastern Venezuela) or those working on the Chevron/Repsol/Teikoku offshore project (Cardon) are threatened (and he doubts they will be taken). Jacob stated

that neither MENPET nor PDVSA has been in contact with Tidewater concerning the situation.

Wood Group

¶10. (C) Simco's General Manager Dave Beacham, a Wood Group expatriate, (strictly protect throughout) told PetAtt that since PDVSA assumed operational control of Simco assets on March 4, six of the eighteen water injection platforms have malfunctioned. Beacham has not agreed to repair the platforms, as PDVSA has not responded to calls or correspondence seeking clarification as to Simco's legal standing. PDVSA, apparently, has not performed any maintenance on the platforms since seizing them. According to Beacham, many of the service companies working in the Lake Maracaibo area have not been paid by PDVSA, including a local medical clinic, which is owed in excess of $2.5 million. The clinic is refusing PDVSA employees treatment unless they pre-pay for services. Beacham stated that construction services companies related to the oil industry are refusing to enter new contracts with PDVSA unless they are pre-paid.

What Does it All Mean?

¶11. (C) The GBRV and PDVSA have for several years discussed publicly their desire to move service companies into joint ventures (JV) after having completed the migration of international oil companies to the JV model. This law provides MENPET and PDVSA with the authority to re-assert their primacy in the services sector and would allow the GBRV, from a position of strength, to offer affected companies the opportunity to enter JVs. Outstanding arrears would likely form part of PDVSA's capital contributions to the new company. Service companies, such as Wood Group and Williams that are directly involved in crude production through their water and gas injection facilities would face the same calculus addressed by the international oil companies in 2007. At that point Exxon Mobil and Conoco Phillips decided to exit the Venezuelan market, while others, such as Chevron and Harvest decided to stay.

¶12. (C) Williams and Wood Group as the majority partners in Wilpro and Simco respectively, have been good citizens in Venezuela. Both cooperated with PDVSA and supported the GBRV during and after the 2002 oil sector strike. They have worked quietly, behind the scenes to maintain operations and communications with PDVSA. Even though they are owed significant amounts of money, they continued operations and never threatened to stop performing on their contracts. Both reluctantly moved to send PDVSA default letters after they had exhausted all other recourses. Williams even worked through an expropriation of an asset expropriated by the GBRV in 2002, filed and won an international arbitration case, and

was compensated for the claim by the GBRV Q) the entire episode was handled quietly and with great tact, with Williams not exposing the GBRV to public embarrassment.

¶13. (C) It is not clear if senior GBRV and PDVSA officials are aware of the price they will have to pay for alienating the service companies with the actions of the last week. Close personal relationships and past support for the GBRV do not appear to matter. The question at this point is how far service companies will go in limiting their exposure to Venezuela. It is hard to imagine Venezuela stabilizing production, let alone increasing it, if it does not have the support of the service companies.

¶14. (SBU) Caracas 564 provides additional perspective on PDVSA's financial situation and its relationship with service companies up until this past week, as well as related references.

CAULFIELD